

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of Federal-State Board on
Universal Service

UNIVERSAL SERVICE ADMINISTRATIVE COMPANY
PETITION FOR WAIVER OF 47 C.F.R. § 54.717(f)

FILED BY THE
UNIVERSAL SERVICE
ADMINISTRATIVE COMPANY
WASHINGTON, D.C.

March 31, 2009

INTRODUCTION AND SUMMARY

Section 54.717 of the Commission's rules requires the Universal Service Administrative Company (USAC or the Administrator) "to obtain and pay for an annual audit conducted by an independent auditor to examine its operations and books of account to determine, among other things, whether the Administrator is properly administering the universal service support mechanisms to prevent fraud, waste and abuse: . . ."¹ Section 54.717(f) requires USAC's outside auditors to submit a draft of the audit report to the Commission's Office of Inspector General (OIG) within 105 calendar days after the end of the audit period (*i.e.*, April 15 of each year, except for leap years, in which case the due date is April 14).

On November 5, 2007, USAC, with the approval of Commission staff, entered into a multi-year, fixed-price, option contract with PricewaterhouseCoopers LLP (PwC) to perform the annual audits required by Section 54.717 of the Commission's rules. USAC's contract with PwC covered the calendar year 2007 annual audit and contains fixed-price renewal options for the calendar year 2008, 2009 and 2010 audits.

Section IV.B.3 of the Memorandum of Understanding (MOU) entered into between the Commission and USAC on September 9, 2008 requires USAC to obtain Commission approval to exercise priced options in competitively awarded contracts where the original contract amount exceeds \$250,000.² As provided in the MOU, on October 1, 2008, USAC requested Commission staff approval to exercise the aforementioned renewal option for USAC's 2008 annual audit. As described in further

¹ 47 C.F.R. § 54.717(a).

² The 2008 FCC-USAC MOU is available at: <http://www.fcc.gov/omd/usac-letters/2008/090508-USAC-MOU.pdf>. The 2008 MOU, among other things, substantially expands Commission staff participation in USAC procurements.

detail below, the Commission's Managing Director did not approve this request until February 13, 2009. Because of this delay, USAC must request that the Commission waive the requirement of 47 C.F.R. § 54.717(f) for the audit period ending December 31, 2008 and grant USAC an extension of the deadline in this rule to July 1, 2009.³

Work on the USAC annual audit by USAC's outside auditors must begin no later than November of each year to ensure the deadline specified in Section 54.717(f) is met. No work on the audit could take place until Commission staff approved the exercise of the option in the PwC contract⁴ and USAC was authorized to engage PwC for the 2008 audit.⁵ After making its request on October 1, 2008, USAC engaged in discussions with Commission staff over several months. What should have been a routine procurement matter was delayed because Commission staff insisted that any audit engagement include a requirement to render a formal opinion, not required by Commission rules and not sought in previous years, on the effectiveness of USAC's internal control structure measured against the requirements of OMB Circular A-123.⁶

Although work on the 2008 audit now has begun, and PwC and USAC are working under an accelerated schedule, the extensive audit work necessary to meet the requirements of Section 54.717(f) cannot be completed by the April 15, 2009 deadline. The inability to meet the April 15 deadline was not the result of a lack of diligence by USAC in seeking approval to exercise the PwC contract option, is not the result of any concerns regarding the contracting process, and is not due to any lack of urgency on the

³ On March 26, 2009, the Executive Committee of the USAC Board of Directors authorized the filing of this petition requesting waiver of the Section 54.717(f) deadline.

⁴ *Id.* at 7.

⁵ See *infra* note 19, Attachment I (On February 13, 2009, the Commission Managing Director sent a letter to USAC approving renewal of the PwC agreement, as originally requested by USAC on October 1, 2008.).

⁶ We note that although USAC is not a federal agency, Commission staff has required that USAC

part of USAC or PwC in performing the audit (once USAC was authorized by Commission staff to engage PwC for the audit).

DISCUSSION

USAC fulfills the annual audit requirement of Section 54.717 by engaging an independent auditing firm to perform an annual audit of USAC's financial statements and a review of certain USAC operating procedures, which is referred to as the "Agreed-Upon Procedures" or "AUP" review. The financial statement audit and the AUP review are performed concurrently.

Following USAC's completion of a full and open competition, Commission staff approved on September 18, 2007 USAC's request to enter into a multi-year contract with PwC for USAC's annual financial audit and AUP review. USAC conducted the procurement in conformance with the requirements specified in the FCC-USAC MOU entered into on June 4, 2007.⁷ The 2007 MOU required USAC to obtain Commission staff approval prior to conducting a competitive solicitation for goods or services having a value in excess of \$250,000. In addition, the 2007 MOU required USAC to obtain Commission staff approval prior to awarding a contract following completion of a competitive solicitation having a value in excess of \$250,000. The contract signed with PwC specified, fixed-fees for the calendar year 2007 audit work and three consecutive option years, with USAC having the right to renew the agreement at its discretion for each option year.

implement an internal control structure consistent with the requirements of OMB Circular A-123.

⁷ The 2007 FCC-USAC MOU is available at: <http://www.fcc.gov/omd/usac-letters/2007/070807-USAC-MOU.pdf>. The 2007 MOU, among other things, imposes substantial Commission staff oversight of USAC procurements and requires that many USAC procurement-related decisions be approved by Commission staff.

PwC completed the USAC 2007 annual financial audit and AUP review on time and within budget. USAC concluded that PwC performed satisfactorily and the firm should conduct the USAC 2008 annual financial audit and AUP review. Therefore, the USAC Board of Directors approved management's recommendation to exercise the first of the three one-year options in the PwC contract to perform the 2008 financial audit and AUP review.

Prior to USAC exercising the renewal option with PwC, however, USAC and the Commission entered into the 2008 MOU. The 2008 MOU substantially expanded Commission staff's management of USAC procurements, including adding a provision that USAC cannot exercise a competitively-awarded contract option having a value in excess of \$250,000 without first obtaining Commission staff approval.⁸ Accordingly, USAC requested permission from Commission staff on October 1, 2008 to exercise the first option in the PwC contract.⁹ No action was taken by Commission staff for thirty days. On October 31, 2008, USAC's Acting Chief Executive Officer, sent an email to the Commission's Managing Director reiterating USAC's request for approval to

⁸See *Comments of the Universal Service Administrative Company* at 83-105 (filed Nov. 13, 2008) in *Comprehensive Review of Universal Service Fund Management, Administration, and Oversight, Federal-State Joint Board on Universal Service*, WC Docket No. 05-195, Notice of Inquiry, FCC 08-189 (rel. Sept.12, 2008) (NOI Comments). As USAC explained in its NOI Comments, this new requirement from the 2008 MOU places USAC in the position of being unable to act predictably with its commercial vendors. Based on experience to date, it is readily foreseeable that circumstances will arise where USAC will want to exercise a contract renewal option for business efficiencies or will need to exercise an option to extend the term of a contract because the Commission has not yet approved a new contract for the required services. Under the 2008 MOU requirements, USAC is faced with the prospect of uncertainty in obtaining approval of the exercise of the option. Such uncertainty could jeopardize program operations and/or substantially increase program administrative costs. USAC respectfully suggested in its NOI Comments that the new MOU requirement is unnecessary and may not best serve the interests of the USF or its stakeholders where the price and time period of the renewal are specified in the contract that Commission staff originally approved.

⁹ See *Attachment A*, Letter from Richard A. Belden, Chief Operating Officer, USAC, to Anthony J. Dale, Managing Director, FCC, dated October 1, 2008.

exercise the option in the PwC contract for the 2008 financial audit and AUP review.¹⁰

In addition, USAC stated that as previously discussed with staff of the Commission's Office of Managing Director (OMD) and OIG, the PwC teams needed to start work as scheduled on November 3, 2008 to meet the regulatory deadlines in 47 C.F.R. § 54.717(f). No reply was received from Commission staff until November 13, 2008, at which time the Managing Director rejected USAC's request to exercise the option in the PwC contract unless an internal controls attest engagement also was performed by PwC at the same time.¹¹

Although this should have been a routine procurement matter, the time between USAC's request for approval of the option exercise and Commission staff approval of that request was more than four months. As discussed in more detail below, USAC was unable to obtain Commission staff approval until February 2009 for what appears to have been reasons related to whether PwC would be required to render a formal opinion on USAC's internal control structure. When USAC conducted the competitive procurement that resulted in the PwC contract, USAC requested services for the audit of USAC's financial statements and AUP review, and at Commission staff's directive, beginning with the audit of calendar year 2008, an annual audit of the effectiveness of USAC's internal controls over financial reporting.¹² However, before PwC could conduct the

¹⁰ See *Attachment B*, Email from D. Scott Barash, Acting Chief Executive Officer, USAC, to Anthony J. Dale, Managing Director, FCC, dated October 31, 2008.

¹¹ See *Attachment C*, Letter from Anthony J. Dale, Managing Director, FCC, to Scott D. Barash, Acting Chief Executive Officer, USAC, dated November 13, 2008.

¹² Section IV.I of the 2007 MOU required USAC to implement an internal control structure "consistent with" the standards and guidance contained in OMB Circular A-123, including the methodology for assessing, documenting, and reporting on internal controls contained in A-123, Appendix A. Generally Accepted Government Auditing Standards (GAGAS) Section 1.23 defines an attest examination as obtaining sufficient, appropriate evidence to express an opinion on whether the subject matter is based on (or in conformity with) the criteria in all material respects or the assertion is presented (or fairly stated), in all material respects, based on the criteria. GAGAS Section 1.25 defines performance audits as

internal controls review, USAC had to develop and implement an internal controls structure consistent with OMB Circular A-123.¹³

To satisfy this requirement, in June, 2007, USAC asked Commission staff to approve a request for proposals (RFP) for the services of a consultant to assist USAC with the review of its existing internal control framework and to implement a comprehensive internal control program that was consistent with the requirements of OMB Circular A-123. Engaging an experienced consultant to assist in this type of effort is a well-established practice. On September 25, 2007, approximately three months after receiving USAC's request, Commission staff approved issuance of the RFP. USAC promptly conducted a full and open competitive procurement and on January 7, 2008 requested approval from Commission staff to engage Grant Thornton, LLP (Grant Thornton). The staff approval to engage Grant Thornton to assist USAC in establishing a formal internal control review program consistent with A-123 was received from Commission staff on February 11, 2008. Grant Thornton began work promptly after a contract was signed on February 27, 2008.

Establishing a formal internal control program consistent with OMB Circular A-123 requires three phases: documentation, testing, and remediation (if any). This extensive set of activities normally takes several years to fully develop, test, and implement. OMB first released Revised Circular A-123 in December 2004 with an expected implementation date of fiscal year 2006. In its April 13, 2006 memorandum titled: *Revised Frequently Asked Questions Regarding OMB Circular A-123*,

engagements that provide assurance or conclusions based on an evaluation of sufficient, appropriate evidence against stated criteria, such as specific requirements, measures, or defined business practices. See <http://www.gao.gov/govaud/govaudhtml/d07731g-3.html#pgfId-1036552>.

¹³ See *supra* note 6.

Management's Responsibility for Internal Control, Appendix A, OMB stated that “implementing the requirements in A-123, Appendix A, and establishing a baseline may span more than one year.” The OMB memorandum also indicates that any agency expecting to be prepared to provide assurance on the effectiveness of internal control over financial reporting as of 2006 should have taken steps in 2005 to develop a detailed implementation plan for conducting the assessment process.

During 4th Quarter 2008, Grant Thornton performed initial testing of key internal controls implemented by USAC. USAC received the results of the Grant Thornton assessment on February 27, 2009, as scheduled, fully consistent with OMB's expectation and in fact ahead of the schedules of most federal agencies. USAC must address the identified control deficiencies identified in the Grant Thornton report, remediate control weaknesses, and retest the controls consistent with the requirements outlined in A-123 in order to have sufficient, appropriate evidence upon which assertions can be based. This effort should be completed in the latter-half of 2009, and, as required by PwC (*see discussion at page 9 below*), must be completed before PwC can perform an attest review of USAC's system of internal controls.

Although an internal controls assessment to be performed in 2009 was included as part of the solicitation for audit services conducted by USAC in 2007, given the ongoing work on this effort into 2009, as discussed above, USAC was not in a position to provide the management assertions required for PwC to perform the internal controls review attest engagement as of and for the year ended December 31, 2008. AICPA Attestation Standard No. 501 (AT 501), published in September 2008, entitled: *An Examination of an Entity's Internal Control Over Financial Reporting That is Integrated with an Audit of*

Its Financial Statements, requires that management make assertions about the effectiveness of internal controls that are supported by sufficient appropriate evidence before an independent auditing firm conducts an attest examination.

During meetings with Commission staff following receipt of the Managing Director's November 13, 2008 letter, USAC reiterated its full support for strong internal controls to protect the Universal Service Fund from waste, fraud and abuse, stated that an internal control review by an independent auditing firm at the appropriate time is desirable although not required by Commission regulations, and reiterated that conducting such a review for calendar year 2008 would not be not possible. On November 21, 2008, USAC resubmitted a revised request for approval to exercise the option with PwC for USAC's calendar year 2008 annual audit and AUP review.¹⁴ USAC's revised request attempted to address OIG staff concerns by proposing a phased-in internal control review process in 2009. In the November 21 letter, USAC also informed Commission staff that it could not provide the required assertions for PwC prior to completion of the internal controls assessment, development, testing and implementation process, which was expected to occur in the second-half of 2009 under the Grant Thornton contract. Further, USAC's November 21, 2008 letter expressed concern that absent immediate authorization for USAC to engage PwC to conduct the annual financial audit and AUP review required under Commission regulations, USAC's ability to meet the deadline set forth in 47 C.F.R. § 54.717(f) was in significant jeopardy.

¹⁴ See Attachment D, Letter from Richard A. Belden, Chief Operating Officer, USAC, to Anthony J. Dale, Managing Director, FCC, dated November 21, 2008.

On December 2, 2008, USAC staff met with OIG and OMD staff to discuss USAC's revised request. On December 9, 2008, USAC sent a letter to the Managing Director again inquiring as to the status of the request to exercise the option in the PwC contract and again reiterating the risk of USAC not meeting the Section 54.717(f) deadline because of the continued delays in obtaining Commission staff approval to have PwC conduct USAC's annual financial audit and AUP review.¹⁵ On December 15, 2008, Commission staff again rejected USAC's request to exercise the PwC option, stating that USAC may only proceed with renewing the engagement with PwC for USAC's annual financial audit and AUP review if USAC also initiates an internal control attest engagement covering calendar year 2008.¹⁶ On January 13, 2009, USAC sent a letter to the Managing Director recapping all prior correspondence and including additional information concerning when USAC would be able to provide the assertions needed for the OMB Circular A-123 compliant internal controls attest engagement.¹⁷ Also included in the January 13 letter from USAC to the Managing Director was a letter from PwC to USAC reiterating its position that it cannot conduct, or even enter into, an examination engagement on the effectiveness of USAC's internal controls over financial reporting until USAC can provide the assertions that completion of the Grant Thornton contract will allow.¹⁸

On February 13, 2009, the Commission's Managing Director authorized USAC to exercise the contract option for PwC to conduct USAC's 2008 annual audit and AUP

¹⁵ See *Attachment E*, Letter from Richard A. Belden, Chief Operating Officer, USAC, to Anthony J. Dale, Managing Director, FCC, dated December 9, 2008.

¹⁶ See *Attachment F*, Letter from Anthony J. Dale, Managing Director, FCC, to Scott D. Barash, Acting Chief Executive Officer, USAC, dated December 15, 2008.

¹⁷ See *Attachment G*, Letter from Richard A. Belden, Chief Operating Officer, USAC, to Anthony J. Dale, Managing Director, FCC, dated January 13, 2009.

¹⁸ See *Attachment H*, Letter from PricewaterhouseCoopers LLP, to Richard A. Belden, Chief Operating

review.¹⁹ This approval does not require USAC to conduct the internal controls attest audit for calendar year 2008 that was required by Commission staff in the previous correspondence mentioned above. However, because of the over four-month delay in obtaining approval for PwC to start work on the 2008 annual audit, this work cannot be completed in time for USAC to provide the OIG a draft report by the April 15, 2009 deadline mandated in 47 C.F.R. § 54.717(f). Barring unforeseen circumstance, USAC believes this work will be completed no later than July 1, 2009.

CONCLUSION

For the forgoing reasons, the Universal Service Administrative Company requests the Commission waive the requirements of 47 C.F.R. § 54.717(f) for the calendar year 2008 annual audit and grant USAC an extension of the deadline set forth in this rule to July 1, 2009.

UNIVERSAL SERVICE
ADMINISTRATIVE COMPANY

/s/ David A. Capozzi
Acting General Counsel
2000 L Street N.W., Suite 200
Washington, DC 20036-4924
Voice: 202.776.0200

March 31, 2009

Officer, USAC, dated January 13, 2009.

¹⁹ See *Attachment I*, Letter from the Anthony J. Dale, Managing Director, FCC, to Scott D. Barash, Acting Chief Executive Officer, USAC, dated February 13, 2009.

ATTACHMENT A

Letter from Richard A. Belden, Chief Operating Officer, USAC, to Anthony J. Dale,
Managing Director, FCC, dated October 1, 2008

VIA EMAIL ONLY

October 1, 2008

Mr. Anthony J. Dale
Managing Director
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Re: Request to Exercise One-year Priced Option for USAC's 2008 Annual Part 54 Audit

Dear Mr. Dale:

Pursuant to the requirements set forth in section IV.B.3.a of the Memorandum of Understanding (MOU) entered into between USAC and the Commission on September 9, 2008, USAC is requesting Commission staff approval to exercise the first of three one-year renewal options under a contract awarded to PriceWaterhouseCoopers LLP (PWC) on November 9, 2007 to perform USAC's annual financial audit and Agreed-Upon Procedures (AUP) review as required by 47 C.F.R. § 54.717.

Following completion of a competitive procurement, Commission staff authorized USAC on September 18, 2007 to award a contract to PWC, which included a base year (2007 audit) and three option years (2008, 2009 and 2010). Based on PWC's satisfactory performance during the base year of the contract, USAC management requested approval from the USAC Audit Committee and the USAC Board of Directors to execute the first of the three priced option years in the contract. The total estimated fees for the 2008 financial audit and AUP review is \$1,357,470 plus expenses. The Audit Committee approved the request on July 28, 2009 and the Board of Directors approved the request on July 29, 2009. PWC was notified of this decision shortly thereafter and commenced initial planning work for the 2008 financial audit and AUP review.

For PWC to complete its work to enable USAC to timely fulfill its obligations under 47 C.F.R. §§ 54.702(g) and 54.717, USAC requests your approval to execute the renewal with PWC no later than October 15, 2008.

Mr. Anthony Dale
Page 2 of 2
October 1, 2008

This will allow completion of the 2008 engagement letters and allow PWC to begin field work on November 3, 2008. Please contact me if you have any questions concerning this matter.

Sincerely,

A handwritten signature in dark ink, appearing to read "Richard Belden", with a stylized flourish at the end.

Richard Belden
USAC, Chief Operating Officer

cc: Kent Nilsson, Inspector General, Federal Communications Commission
Mark Stephens, Chief Financial Officer
Mr. Mark Stone, Deputy Managing Director

ATTACHMENT B

Email from D. Scott Barash, Acting Chief Executive Officer, USAC,
to Anthony J. Dale, Managing Director, FCC, dated October 31, 2008

From: Scott Barash
Sent: Friday, October 31, 2008 3:54 PM
To: Anthony.Dale@fcc.gov
Cc: 'Kent Nilsson'; Mark Stephens; Mark Stone; Richard Belden
Subject: Renewed/High Priority USAC request for approval to exercise priced option for PWC Part 54 audit engagement
Importance: High

Tony:

I'm writing to call your attention to a matter of some urgency.

On October 1, 2008, USAC sent a request to the FCC for approval to execute the priced option with PriceWaterhouseCoopers (PWC) to have them conduct the financial audit and Agreed Upon Procedures (AUP) review as required under Commission rules. I have attached the letter for your convenience.

As noted in the letter, in order for PwC to complete its work and allow USAC to timely fulfill our obligations under the Commission's rules, PWC was to commence field work on Monday, November 3. Members of the USAC Executive Committee raised this issue during their meeting with Kent and members of your staff on Tuesday of this week, and I understand that Richard followed up with an email to Kent on Wednesday. A PwC team was scheduled to begin the AUP work at USAC's contractor Solix that day. Because we do not have authorization to exercise the engagement option with PwC, however, we have instructed PWC to not begin their work until further notice.

USAC is fully committed to meeting the Commission's audit requirements and deadlines, but the audit firm cannot begin its work without an engagement letter, which we cannot sign without your authorization to exercise the option to re-engage PWC

Please let us know if there is anything USAC can do to expedite this matter.

Thanks for your consideration and attention.

--Scott

ATTACHMENT C

Letter from Anthony J. Dale, Managing Director, FCC, to Scott D. Barash, Acting Chief
Executive Officer, USAC, dated November 13, 2008

FEDERAL COMMUNICATIONS COMMISSION
Washington DC 20554

**OFFICE OF
MANAGING DIRECTOR**

November 13, 2008

Mr. Scott D. Barash
Acting Chief Executive Officer
Universal Service Administrative Company
2000 L St. NW, Suite 200
Washington, DC 20036

RE: Request to Exercise One-year Priced Option for USAC's 2008 Annual Part 54 Audit

Dear Mr. Barash:

We have reviewed your request for approval to exercise a one-year renewal option under USAC's contract with PriceWaterhouseCoopers (PWC) for audit services.¹ We disapprove your proposed exercise of the renewal option, and advise you to make the scope of work consistent with the solicitation that FCC approved for this contract, and to then re-submit the renewal for approval, as described below.

In a letter dated March 14, 2005, the Commission provided USAC with procurement guidance that requires USAC to secure the approval of the Commission before issuing solicitations or making contract award decisions for: "(1) all sole source contracting actions above \$25,000; and (2) all competitive contracting actions in excess of \$250,000."² In addition, the Commission instructed that "USAC's contracting actions must be consistent with Federal Acquisition Regulation ("FAR") requirements to the extent applicable, including FAR requirements for full and open competition, permissible business practices, and audit requirements."³ These procurement requirements are also in the USAC/FCC Memorandum of Understanding, executed September 9, 2008.⁴

¹ Letter from Richard A. Belden, Chief Operating Officer, USAC to Anthony J. Dale, Managing Director, FCC, dated Oct. 1, 2008.

² Letter from Jeffrey Carlisle and Andrew Fishel, FCC to Lisa Zaina, USAC at 3 (Mar. 14, 2005) ("March 14, 2005 Letter").

³ March 14, 2005 Letter at 2.

⁴ See Memorandum of Understanding between the Federal Communications Commission and the Universal Service Administrative Company, executed September 9, 2008, at 6-7.

The USAC RFP which FCC approved, and which resulted in USAC's contract with PWC, provided that:

"The annual audit shall include...during each of the three potential option years, an attest engagement to issue an examination report on the effectiveness of USAC's internal control over financial reporting for the USF."⁵

USAC's letter requesting approval to exercise the option specified that the scope of work would be, "to perform USAC's annual financial audit and Agreed-Upon Procedures (AUP) review."⁶ A subsequent email from USAC's CFO confirmed that the scope of work which USAC proposed for the renewal did not include an attest engagement for internal controls.⁷

We find that the attest engagement for internal controls, as specified in the RFP, is still required. Therefore, we do not approve the exercise of the renewal option as proposed by USAC. We advise you to revise the proposed renewal, to explicitly include an attest engagement for internal controls as specified in the RFP. When you send the revised proposed renewal for approval, please include the actual document by which USAC plans to exercise the option, regardless of whether this document is styled an engagement letter, a contract amendment, or otherwise. This document should specify the work to be accomplished, the amounts USAC will pay, and the basis of payment (fixed price for accepted deliverables, price per hour by labor category, reimbursement of authorized costs, etc.).

If you have any questions, please do not hesitate to contact me. Thank you for your prompt attention to this matter.

Sincerely,


Anthony J. Dale
Managing Director

⁵ USAC, "Request for Proposals for Annual Audit of the Universal Service Administrative Company", pp. 1-2.

⁶ Letter from Richard A. Belden, Chief Operating Officer, USAC to Anthony J. Dale, Managing Director, FCC, dated Oct. 1, 2008, p. 1.

⁷ Email from W.B. Erwin to Mark Stephens, sent Oct. 14, 2008, "Subject: FW: Request to Exercise One-year Priced Option for USAC's 2008 Annual Part 54 Audit".

cc: USAC Board of Directors
Mark Stone, Deputy Managing Director, FCC
Mindy Ginsburg, Deputy Managing Director, FCC
Mark Stephens, Chief Financial Officer, FCC
Kent R. Nilsson, Inspector General, FCC
David Reed, Financial Operations, FCC

ATTACHMENT D

Letter from Richard A. Belden, Chief Operating Officer, USAC, to Anthony J. Dale,
Managing Director, FCC, dated November 21, 2008

By E-mail and First Class Mail

November 21, 2008

Mr. Anthony J. Dale
Managing Director
Federal Communications Commission
445 12th Street, S.W.
Washington, DC 20554

Re: Request to Exercise One-year Priced Option for USAC's 2008 Annual Part 54 Audits and Internal Controls Review

Dear Mr. Dale:

This letter is in response to your November 13, 2008 letter disapproving USAC's October 1, 2008 request to exercise a competitively-bid, one-year priced option for engaging PricewaterhouseCoopers LLP (PwC) to conduct USAC's 2008 annual Part 54 financial audit and Agreed-Upon Procedures (AUP) review. The request had been approved by the USAC Board of Directors as recommended by management.

The reason for disapproving the request stated in your letter was that the request to exercise the option did not include the performance of an internal controls attest examination. Your November 13 letter directed USAC to revise its request to exercise the one-year PwC option to include an engagement to perform an attest examination for USAC's internal controls and resubmit the request to exercise the option.

After consulting with PwC regarding the feasibility of conducting a complete internal controls attest examination at this time, USAC hereby amends its original request by requesting Commission approval to exercise the first of three one-year renewal options to engage PwC to immediately perform USAC's annual financial audit and AUP review for 2008 as required by 47 C.F.R. § 54.717 and to perform an attest examination for internal controls in accordance with the plan and schedule as discussed below.

As you are aware, USAC engaged Grant Thornton, LLP (GT) to assist in establishing a formal internal control review program consistent with Office of Management and Budget (OMB) Circular No. A-123 in accordance with the FCC-USAC Memorandum of Understanding. The GT engagement was approved by the FCC on February 11, 2008, and GT began work immediately thereafter.

Establishing a formal internal control program consistent with OMB Circular No. A-123 requires three stages: documentation, testing, and remediation (if any). This is a very extensive set of activities and normally takes from one to two years to fully develop, test, and implement. USAC is in the ninth month of this effort.

Development of USAC Internal Controls Program

GT began the process of developing a formal internal controls program for USAC by first performing a materiality assessment of USAC's business processes and the impact of each business process on USAC's financial statements. GT gained a thorough understanding of each key business process identified by reviewing existing documentation, interviewing process owners, and observing the processes. Based upon this research, GT developed narratives and workflows for each key business process. GT also began to identify risks, control objectives, and control activities within each business process. GT created documentation at a level of significant detail to help management understand the entire financial reporting process and identify how processes relate to financial reporting assertions, potential errors or misstatements, and control objectives. The process narratives and workflows were reviewed and approved by the appropriate process owners. As contemplated under the terms of the engagement, GT utilized approximately 10 consultants to conduct these activities, which took approximately six months to complete.

During late 3rd Quarter 2008, once the process narratives were completed and risks, control objectives, and control activities established, planning for testing of key control activities commenced. This planning for testing included identification of key controls to be tested, creation of test procedures, and determination of the necessary documentation to be provided by USAC.

GT is currently completing the test planning phase and moving into actual testing. To begin testing of the design and operating effectiveness of the key controls, GT is requesting the necessary documentation and executing its test plans through in-depth testing of key controls focusing on both design and operating effectiveness. The test of design effectiveness entails a walkthrough of each control using a sample of one. The test of operating effectiveness seeks to validate, by using a larger sample, that well-designed controls are operating as intended.

Upon completion of the testing, projected for December 2008, GT will consolidate the results of its testing into an *Assessment of Internal Controls over Financial Management Processes* that will, among other things, detail the results of testing, findings, and recommendations for remediation. Preparation of such a report is consistent with development of an internal controls program as contemplated by OMB Circular No. A-123. GT has advised USAC that the report is projected to be completed by January 31, 2009. Once USAC receives the recommendations, USAC will immediately initiate appropriate corrective actions, if any. These remediation activities will be closely monitored, and once completed, GT will retest to ensure the efficacy of the remediation

activities. A timeline of this process is attached for your information. It includes program development, testing, remediation, on-going testing, assertions and timing of the attest engagement discussed below.

Attest Examination of Internal Controls

USAC's internal controls for financial reporting have long been subject to auditor review. PwC reviews USAC's internal controls over financial reporting as part of the financial audit required by Commission rules and as required by Generally Accepted Government Auditing Standards (GAGAS). This requirement was included in the engagement letter dated October 29, 2007 between PwC and USAC and will be included in the engagement letter for 2008.

USAC understands that a separate examination of USAC's internal controls was contemplated in the initial RFP that resulted in the engagement of PwC. PwC, however, has advised USAC that an internal controls attest engagement is most effective only when an auditor can test multiple periods of controls data produced by the auditee. Given USAC's business cycles and reporting requirements, PwC has advised USAC that an effective attest engagement requires a minimum of two quarters worth of actual data once a formal, full internal controls program is implemented in order to select a valid sample of data to test. A letter from PwC explaining the rationale for needing two quarters of actual data before starting the attestation audit on internal controls is attached.

Over the next six months, as USAC proceeds with its planned internal control program developments, USAC may be in a position to make interim assertions about certain segments of its financial reporting internal controls. Accordingly, PwC will conduct regular discussions with USAC over the next six months regarding management's progress related to those internal control segments, and the nature and extent of management's possible interim assertions about controls. PwC will discuss with management the types of interim audit work over such segments that might be appropriate in the circumstances. For example, depending upon the facts at that time, PwC's audit work might include interim (e.g., prior to December 31, 2009) agreed-upon procedures, attestations, or examinations related to the internal control segments in instances where management can make necessary assertions. Such interim work would contribute to the ultimate goal that PwC be engaged to perform an overall opinion examination of USAC's internal controls.

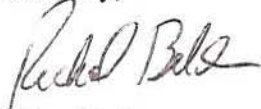
The financial statement audit and AUP review mandated by Commission rules are subject to a regulatory deadline under 47 C.F.R. Part 54. Commission regulations do not require the internal control audit be conducted in conjunction with the financial statement audit. USAC would work with PwC to determine the correct timing of the overall internal control audit. This would allow the AUP and the financial statement audit to move forward and insure that the dates prescribed by the FCC in Part 54 are met, while providing for an attestation audit of internal controls under the first option year of the PwC engagement. As requested in your November 13, 2008 letter, attached are three

draft engagement letters for PwC to perform the USAC annual financial audit, AUP review, and internal controls engagement.

USAC management has reviewed this matter with the Audit Committee of the USAC Board of Directors, which concurs in the approach and timeline outlined in this letter.

Thus, USAC requests immediate approval to exercise the first of three one-year renewal options with PwC to perform USAC's 2008 annual financial audit, AUP review, and an audit of internal controls. Without your immediate approval, PwC's ability to complete USAC's 2008 financial audit and AUP review to enable USAC to comply with the deadline established by the Commission in 47 C.F.R. § 54.717(f) is in substantial jeopardy.

Sincerely,



Richard Belden
Chief Operating Officer

Attachment: Timeline of Internal Controls Development and Examination
PricewaterhouseCoopers LLP Letter
Draft Engagement Letter for PwC Annual Financial Audit
Draft Engagement Letter for PwC AUP Review
Draft Engagement Letter for Internal Controls Engagement

cc: (via email only)
Mindy Ginsburg, Deputy Managing Director, FCC
Kent R. Nilsson, Inspector General, FCC
David Reed, Financial Operations, FCC
Mark Stephens, Chief Financial Officer, FCC
Mark Stone, Deputy Managing Director, FCC

ATTACHMENT E

Letter from Richard A. Belden, Chief Operating Officer, USAC, to Anthony J. Dale,
Managing Director, FCC, dated December 9, 2008

Via E-Mail And First Class Mail

December 9, 2008

Mr. Anthony Dale
Managing Director
Federal Communications Commission
445 12th Street, S.W.
Washington, DC 20554

Re: Status of Approval of the Part 54 Audit and AUP

Dear Mr. Dale:

On October 1, 2008, USAC requested the Commission's approval to proceed with the award of the 1st option year of the competitively bid contract with PricewaterhouseCoopers LLP (PwC) for USAC's Part 54 annual financial statement audit and agreed-upon-procedures (AUP) review. On November 13, 2008, the Commission rejected USAC's request indicating that USAC had not included an internal control component that had been included in the original procurement proposal. USAC revised its request to include an internal control review, and resubmitted the request to exercise the 1st option year of the PwC contract on November 21, 2008. In my November 21 letter, I stated that without immediate approval, PwC's ability to complete USAC's 2008 annual financial audit and AUP review by the deadline established by the Commission in 47 C.F.R. § 54.717(f) is in substantial jeopardy.

USAC and FCC staff met on December 2, 2008, and discussed the revised USAC request as set forth in my November 21 letter to you. We provided an overview of the proposal and described the significant progress that has been made in documenting and testing internal controls at USAC. While having made significant progress, we also addressed the inability of USAC at this time to be able to provide certain assertions related to the internal control process necessary for an attest examination. Two partners from PwC were present and indicated that USAC's progress and approach were similar to other companies that were implementing a comprehensive internal controls program. We provided responses to procurement related questions, and ended the meeting to await the FCC's response to our revised proposal. To date, we have not received a response.

Section 54.717(f) of the Commission's rules requires that the financial statement audit and the AUP review be submitted to the FCC within 105 days following the end of the audit period, or approximately April 15 of the year following the year audited. USAC and PwC prepared their audit plan to meet this deadline based on initiating the audit on approximately November 1, 2008 (consistent with prior years). Experienced staff that

Mr. Anthony J. Dale
Federal Communications Commission
December 9, 2008
Page 2 of 2

had participated in the previous audit was scheduled for this year's audit. With the delay that has ensued in beginning the financial audit and AUP review, this experienced staff has been lost to other audits and many will not be able to return to the USAC audit. This loss of experienced audit personnel and the significant delay in beginning the financial statement and AUP review continues to place USAC's ability to comply with the deadline established in 47 C.F.R. § 54.717(f) in substantial jeopardy.

USAC would like to proceed as soon as possible with the financial statement audit and AUP review. We request that you bifurcate the current request and allow USAC and PwC to begin the financial statement audit and the AUP review. Although given the late date, there can be no assurance that the annual financial audit and the AUP review can be completed by the date specified in Section 54.717(f), allowing USAC to start this work immediately will give USAC and PwC the best chance to meet the April 15th deadline while the remaining issues associated with an internal controls review are resolved on a separate track.

Sincerely,



Richard Belden
Chief Operating Officer

cc: Kent R. Nilsson, Inspector General
Dana Shaffer, Chief, Wireline Competition Bureau

ATTACHMENT F

Letter from Anthony J. Dale, Managing Director, FCC, to Scott D. Barash, Acting Chief
Executive Officer, USAC, dated December 15, 2008

FEDERAL COMMUNICATIONS COMMISSION
Washington DC 20554

**OFFICE OF
MANAGING DIRECTOR**

December 15, 2008

Mr. Scott D. Barash
Acting Chief Executive Officer
Universal Service Administrative Company
2000 L St. NW, Suite 200
Washington, DC 20036

RE: Request to Exercise One-year Priced Option for USAC's 2008 Annual Part 54 Audit

Dear Mr. Barash:

We have reviewed your amended request for approval to exercise a one-year renewal option under USAC's contract with PriceWaterhouseCoopers (PwC) for audit services.¹ We require changes from what you have requested, and we authorize you to exercise the renewal once you have made the changes we specify, as described below.

In a letter dated March 14, 2005, the Commission provided USAC with procurement guidance that requires USAC to secure the approval of the Commission before issuing solicitations or making contract award decisions for: "(1) all sole source contracting actions above \$25,000; and (2) all competitive contracting actions in excess of \$250,000."² In addition, the Commission instructed that "USAC's contracting actions must be consistent with Federal Acquisition Regulation ("FAR") requirements to the extent applicable, including FAR requirements for full and open competition, permissible business practices, and audit requirements."³ These procurement requirements are also in the USAC/FCC Memorandum of Understanding, executed September 9, 2008.⁴

¹ Letter from Richard A. Belden, Chief Operating Officer, USAC to Anthony J. Dale, Managing Director, FCC, dated Nov. 21, 2008.

² Letter from Jeffrey Carlisle and Andrew Fishel, FCC to Lisa Zaina, USAC at 3 (Mar. 14, 2005) ("March 14, 2005 Letter").

³ March 14, 2005 Letter at 2.

⁴ See Memorandum of Understanding between the Federal Communications Commission and the Universal Service Administrative Company, executed September 9, 2008, at 6-7.

The USAC RFP which FCC approved, and which resulted in USAC's contract with PwC, provided that:

"The annual audit shall include...during each of the three potential option years, an attest engagement to issue an examination report on the effectiveness of USAC's internal control over financial reporting for the USF."⁵

Your letter proposes that instead of conducting an attest engagement for internal controls at this time, PwC would perform interim audit work over the next six months, related to the internal control segments in instances where management can make necessary assertions.

We have been advised by FCC's Office of Inspector General, that the attest engagement for internal controls is still required at this time. Therefore, we do not approve the exercise of the renewal option as proposed by USAC. We require you to revise the proposed renewal to explicitly include an attest engagement for internal controls, which will be conducted at the same time as USAC's 2008 annual Part 54 audits.

Your letter notes that USAC management cannot yet provide the auditors with an assurance that USAC's internal controls are operating effectively. FCC's Office of Inspector General has determined that an attest engagement for internal controls is possible even if management can make only partial assurances or no assurance. We refer you to the Implementation Guide for OMB Circular A-123, for an example of assertions that management can provide to the auditors when it cannot provide a statement of assurance.⁶ If USAC can provide only partial assurance, or no assurance, then the scope of work that the auditors can perform will be less than the work anticipated for a complete attest engagement on internal controls. We therefore expect USAC to negotiate a price for this work that is significantly less than the \$752,785 that PwC proposed for a complete internal control audit in the first option year.

In summary, we authorize USAC to exercise the year two renewal options in its existing contract with PwC for financial statement audit and for agreed-upon procedures, if and only if USAC simultaneously places an order under said contract for PwC to conduct an attest engagement for internal controls, and to complete such attest engagement at the same time as the financial statement audit. Pricing for the financial statement audit and agreed-upon procedures should be as provided in the existing contract. Pricing for the attest engagement for internal controls should be negotiated at a reasonable amount for the scope of work. We do not authorize USAC to purchase any advisory or consulting services, or any services not specified in this paragraph, under the PwC contract at this time.

⁵ USAC, "Request for Proposals for Annual Audit of the Universal Service Administrative Company", pp. 1-2.

⁶ *Implementation Guide for OMB Circular A-123, Management's Responsibility for Internal Control, Appendix A, Internal Control over Financial Reporting* (Chief Financial Officer's Council, July 2005), Exhibit 6C on page 65.

Since time is of the essence, USAC may proceed in accordance with these instructions without further approval from FCC. Within seven days after you enter into any contract amendment, engagement letter, or other contractual action with PwC, please send us a copy of such document.

If you have any questions, please do not hesitate to contact me. Thank you for your prompt attention to this matter.

Sincerely,


Anthony J. Dale
Managing Director

cc: USAC Board of Directors
Mark Stone, Deputy Managing Director, FCC
Mindy Ginsburg, Deputy Managing Director, FCC
Mark Stephens, Chief Financial Officer, FCC
Kent R. Nilsson, Inspector General, FCC
David Reed, Financial Operations, FCC

ATTACHMENT G

Letter from Richard A. Belden, Chief Operating Officer, USAC, to Anthony J. Dale,
Managing Director, FCC, dated January 13, 2009



VIA E-MAIL AND FIRST CLASS MAIL

January 13, 2009

Anthony J. Dale
Managing Director
Federal Communications Commission
445 12th Street, S.W.
Washington, DC 20554

Re: Request to Exercise One-Year Priced Option for USAC's 2008 Annual Part 54 Audit

Dear Mr. Dale:

USAC received your letter dated December 15, 2008, in response to our request to exercise the one-year priced option with PricewaterhouseCoopers (PwC) for USAC's 2008 annual financial audit and agreed upon procedures (AUP) review required under Part 54 of the Commission's regulations. In addition to the annual financial audit and AUP review required by Commission rules, your December 15 letter instructs USAC to contract with PwC to perform, for the first time since USAC's designation as Universal Service Fund (USF) administrator, an "attest engagement" for internal controls over financial reporting for the USF for the year ended December 31, 2008.

For reasons previously discussed on several occasions with your staff and the Office of Inspector General (OIG), and as described in further detail below, the attest engagement for internal controls as of December 31, 2008, which is not a requirement under Part 54, cannot be performed. As discussed in previous correspondence, USAC has proposed a phased review of its internal controls in 2009 in accordance with the timetable previously outlined to Commission staff that is fully consistent with guidance set forth in Office of Management and Budget (OMB) Circular A-123 regarding internal controls for federal agencies.

USAC reiterates at this time its request for immediate approval to engage PwC to commence the financial audit and AUP review that are required by Commission regulation. Absent such approval, USAC will be unable to meet the Part 54 deadline for submission of the financial audit and AUP review. Even if USAC receives immediate approval to engage PwC to perform the required financial audit and AUP review, USAC is extremely concerned that PwC will be unable to meet the Commission's April 15, 2009, deadline for submission of its reports despite the best efforts of USAC and PwC.

Following is a discussion of this matter, including a review of USAC's previously stated explanation as to why USAC is not in a position at this time to provide the management assertions required by PwC for it to perform an internal control attest engagement.

Background

The immediate issue at hand is a straightforward procurement matter. Section IV.B.3.a of the 2008 FCC-USAC Memorandum of Understanding (MOU) requires USAC to obtain FCC approval to exercise renewals of contracts where the original contract amount exceeded \$250,000 even if the contract contains competitively-bid priced renewal options. After obtaining authorization from the USAC Board of Directors, USAC requested your approval as required by the MOU to renew the engagement with PwC for USAC's annual financial audit and AUP review on October 1, 2008. On November 13, 2008, you rejected our request. Copies of USAC's October 1 letter to you and your November 13 reply are attached to this correspondence. The basis for the rejection was that USAC's proposed engagement with PwC did not contemplate an attest engagement for a review of USAC's system of internal controls. Although as stated below, USAC fully supports a strong internal controls program and agrees that an internal control review by an independent audit firm at the appropriate time is desirable, such a review is not required under Commission regulations and as discussed in detail below, conducting such a review as of year-end 2008 is not possible.

After meetings with the Office of Inspector General (OIG) and your staff, and in consultation with the Audit Committee of the USAC Board of Directors, on November 21, 2008, USAC resubmitted a revised request for approval to exercise the competitively-bid option with PwC. A copy of USAC's November 21 letter is attached to this correspondence. USAC's revised request attempted to address concerns expressed by OIG staff by proposing a phased internal control review process in 2009. In my November 21, 2008 letter to you, USAC also expressed concern that absent immediate approval for USAC to engage PwC to conduct the annual financial audit and AUP review required under Commission regulations, USAC's ability to meet the deadline set forth in 47 C.F.R. § 54.717(f) was in significant jeopardy. On December 2, 2008, USAC staff met with OIG staff and your staff to discuss our revised request. On December 9, 2008, I sent a letter, a copy of which is attached to this correspondence, inquiring as to the status of our request and again reiterating the risk of USAC not meeting the Section 54.717(f) deadline because of the continued delays in obtaining FCC staff approval to have PwC conduct USAC's annual financial audit and AUP review. As discussed above, on December 15, 2008, you again rejected USAC's request to exercise the PwC option, stating that USAC may only proceed with renewing the engagement with PwC for USAC's annual financial audit and AUP review if USAC also initiates an internal control attest engagement covering the year ended December 31, 2008. A copy of your December 15 letter is attached to this correspondence.

As we have made clear to the OIG and your staff, USAC is not in a position at this time to provide the necessary assertions upon which an attest engagement covering the year ended December 31, 2008, must be based because USAC has not completed its

assessment, testing and implementation of an internal controls program consistent with OMB Circular A-123 (A-123). As you are aware, this significant effort commenced in February 2008, is on schedule, and will be completed in early 2009. In light of that schedule, of which your staff and OIG were fully advised, the requirement in your December 15 letter that USAC engage PwC to conduct an attest engagement covering calendar year 2008—the period during which the internal controls assessment project described above was being conducted—is neither reasonable nor practical.

Section IV.G of the initial 2007 FCC-USAC Memorandum of Understanding required USAC to implement an internal control structure “consistent with” the standards and guidance contained in A-123, including the methodology for assessing, documenting, and reporting on internal controls contained in A-123 Appendix A. In order to satisfy this requirement, in June, 2007, USAC submitted to the FCC for approval a request for proposals (RFP) to seek the services of a contractor to assist USAC with the review of its existing internal control framework and to implement a comprehensive internal control program. Engaging an experienced contractor to assist in such an effort is a well-established standard practice. Approximately three months later, the FCC approved the request on September 25, 2007. USAC conducted a full and open competitive procurement process and on January 7, 2008 requested approval from the FCC to engage the winning bidder, Grant Thornton, LLP (GT). The final FCC approval to engage GT to assist in establishing a formal internal control review program consistent with A-123 in accordance with the FCC-USAC MOU was received on February 11, 2008. GT began its work immediately after a contract was signed on February 27, 2008.

A-123 requires management of federal agencies to complete specific assessment and documentation requirements to support an assurance statement regarding the effectiveness of internal control over financial reporting. These requirements, as discussed below, are rigorous and generally take two to three years for a federal agency to complete. OMB first released Revised Circular A-123 in December 2004 with an expected implementation date of fiscal year 2006. In its April 13, 2006 memorandum titled *Revised Frequently Asked Questions Regarding OMB Circular A-123, Management’s Responsibility for Internal Control, Appendix A*, OMB stated that “implementing the requirements in the A-123, Appendix A, and establishing a baseline may span more than one year.” The OMB memorandum also indicates that any agency expecting to be prepared to provide assurance on the effectiveness of internal control over financial reporting as of 2006 should have taken steps in 2005 to develop a detailed implementation plan for conducting the assessment process. USAC expects to complete this extensive effort within one year, which is fully consistent with OMB’s expectation and is in fact ahead of the schedules of most federal agencies.

OMB A-123 Requirements and USAC’s Implementation Pursuant to the MOU

A-123 requires management of federal agencies to conduct an assessment in accordance with the requirements in Appendix A in order to provide assurance concerning the effectiveness of internal controls over financial reporting. The requirements in Appendix A and USAC’s actions to date to meet these requirements are summarized below:

- Establish a Senior Assessment Team that has responsibility for carrying out or directing the assessment.
 - USAC created a new position and hired a Senior Manager of Internal Controls whose primary responsibility is to ensure the success of USAC's A-123 implementation.
 - USAC engaged GT to assist in establishing a formal internal control review program consistent with A-123. As noted above, approval from the FCC was received on February 11, 2008. The contract was executed on February 27, 2008, and GT started work on February 28, 2008.
 - USAC created a Senior Management Council to support the implementation of management's responsibility for internal controls.
- Evaluate Internal Control at the Entity Level (Second Quarter 2008).
 - GT began the process of developing a formal internal controls program for USAC by first performing a materiality assessment of USAC's business processes and the impact of each business process on USAC's financial statements. GT gained a thorough understanding of each key business process identified by reviewing existing documentation, interviewing process owners and observing the processes.
 - GT also began to identify risks, control objectives and control activities within each business process.
- Evaluate Internal Control at the Process, Transaction, or Application Level (Third and Fourth Quarter 2008).
 - GT created detailed documentation to assist management in understanding the entire financial reporting process and identify how processes relate to financial reporting assertions, potential errors or misstatements and control objectives. The process narratives and workflows were reviewed and approved by the appropriate process owners.
 - USAC and GT identified significant accounts, evaluated the major classes of transactions, identified key controls to be tested, created test procedures, requested documents needed from USAC to conduct testing and began executing test plans.
 - GT executed its test plans through in-depth testing of key controls focusing on both design and operating effectiveness. The test of design effectiveness entailed a walkthrough of each control using a sample of one. The test of operating effectiveness seeks to validate, by using a larger sample, that well-designed controls are operating as intended. ***This testing is a key step that must be completed in order to move on to the next step in the process.***
 - The testing was completed in December 2008. GT is in the process of consolidating the results of its testing into an *Assessment of Internal Controls over Financial Management Processes* that will, among other things, detail the results of testing, findings, and recommendations for

remediation. Preparation of such a report is consistent with development of an internal controls program as contemplated by A-123.

- After evaluating the results of the testing phase, USAC will immediately initiate appropriate corrective actions. These remediation activities will be closely monitored, and once completed, the controls will be retested to ensure the efficacy of the remediation activities
- Determine Overall Assessment of the Design and Operation of Internal Control Over Financial Reporting.
 - USAC is currently *unable to determine an overall assessment* of internal controls as of December 31, 2008 because USAC has not completed the requirements for testing and evaluating the effectiveness of the design and operation of key controls. The fact that USAC is continuing to work with GT in this process is fully consistent with the expectation that an A-123-compliant internal controls program generally requires at least one year to implement and test before it can be audited.

As stated above, GT was engaged in February 2008 to plan the engagement, evaluate internal control at the entity level, evaluate internal control at the process level, test controls, and provide a gap analysis. The timeline included in GT's proposal to complete this work was one year. This timeline was reviewed and approved by the Commission in connection with the approval of USAC's decision to engage GT. Therefore, these activities were projected to be completed at the earliest by the end of February 2009.

USAC is on schedule to complete the extensive activities required to establish, document, and test its internal control program within the one-year timeline contemplated by GT. As noted above, this is a highly compressed schedule when compared to the OMB timeline for federal agency implementation. After GT has completed its work, USAC must address any identified gaps, remediate control weaknesses, and retest the controls in accordance with the requirements outlined in A-123 in order to have sufficient, appropriate evidence upon which assertions can be based. A-123 guidance does not allow for shortcuts. Management must complete the aforementioned requirements in order to make assertions related to internal control that are necessary for an independent audit firm to conduct an attest examination. All this must occur before PwC can perform an attest review of USAC's system of internal controls.

Internal Control Assurance Statement Requirements

USAC understands that the OIG has advised you that an attest engagement for internal controls is possible even if management can make only partial assurances or no assurances. It is correct that the A-123 Implementation Guide for A-123 as well as A-123 itself provide for a statement of assurance, a statement of qualified assurance, or a statement of no assurance. However, as discussed below, it is beyond dispute that an assessment of internal control of the type being performed by GT must be completed before any representations of assurance regarding internal controls over financial reporting can be provided.

- The A-123 Implementation Guide at page 39 states that “the Senior Assessment Team will decide *based on their analysis of the findings* and recommend ...the level of assurance the agency head should provide on internal control over financial reporting.”
- The required language in the example assertion referenced in your December 15, 2008, letter includes the phrase “The [Agency] *conducted its assessment of the effectiveness of internal control in accordance with OMB A-123.*”
- A-123 states under section VI. *Reporting on Internal Control*, B. that “the assurance ...*is based on the results of management’s assessment conducted in accordance with the requirements in Appendix A.*”

Therefore, the review and assessment of USAC’s internal controls must be completed in order for USAC to provide *any* level of assurance to the audit firm, even no assurance. There is simply no provision for providing management assurance or assertions without completing the testing of the controls. Because USAC has not completed the assessment in accordance with the requirements in A-123, Appendix A, as outlined above, USAC does not have sufficient, appropriate evidence to provide any level of assurance at this time. This is not due to any delay or lack of diligence on USAC’s part. As discussed above, the GT project is on the schedule acknowledged and approved by Commission staff.

USAC is not aware of any factual or legal basis for the OIG’s assertion that USAC must engage an audit firm to conduct an attestation examination of USAC’s internal controls as of December 31, 2008. In fact, A-123 does not require an attest engagement be conducted on internal controls over financial reporting. To our knowledge, only three federal agencies—the Social Security Administration, Nuclear Regulatory Commission and Department of Homeland Security (required under separate legislation)—actually choose to obtain an external opinion on internal controls. The FCC itself is not subject to any requirement to obtain an attest opinion on internal control over financial reporting and we are not aware of any effort by the Commission to do so.

USAC has clearly and regularly communicated its planned project milestones to the FCC. The FCC approved the contract with GT, which included a timeline of one year (February 2008-February 2009) to complete the engagement to evaluate internal control at the entity level, evaluate internal control at the process level, test controls, and provide a gap analysis. USAC has held monthly status meetings to update your staff on our progress since April 2008. We have also held three Senior Management Council meetings that were open to the FCC. All of these meetings presented clear timelines for the activities consistent with the statement of work in the FCC approved contract with GT. USAC has worked diligently and is on target with our communicated plan, and we fully expect to complete the stated milestones on time.

Applicable Audit Standards and Requirements

We have been advised by PwC that the professional standard that would guide the firm's execution of an attest examination over internal controls is AICPA Attestation Standard No. 501 ("AT 501"), published in September 2008, entitled *An Examination of an Entity's Internal Control Over Financial Reporting That is Integrated with an Audit of its Financial Statements*. The GAO has incorporated the AICPA's standards for attestation engagements into Generally Accepted Government Auditing Standards ("GAGAS"). PwC has informed USAC that it is unable to accept an internal controls attestation engagement until USAC is prepared to provide the required management representations. A letter to USAC from Donald Phillips, the PwC partner handling the USAC engagement, is attached to this letter. As discussed above, USAC management will not be in a position to provide the required representations until the assessment of internal controls is complete, subjected to testing and any remediation activity has been in operation for a reasonable period of time.

Summary and Conclusion

USAC fully recognizes the importance of a robust system of internal controls to provide assurance over the effectiveness and efficiency of operations, the reliability of financial reporting, and compliance with applicable laws and regulations. USAC also appreciates the MOU requirement that USAC implement a system of internal control consistent with A-123 and the instruction from Commission staff to obtain an opinion from an external auditor of the effectiveness of USAC's internal control over financial reporting of the USF as outlined in USAC's contract with PwC. USAC has worked diligently and applied significant resources to complying with these directives and is on track to do so. USAC obtained Commission approval for the GT contract from the FCC, including the statement of work and the contract timeline; executed the contract according to the statement of work; and is on schedule and have communicated the project status regularly to the FCC. In response to the directive that USAC obtain an internal control opinion immediately, USAC proposed a reasonable process consisting of a phased review to be conducted by PwC during 2009. The proposed phased review enables USAC to complete the assessment in accordance with the requirements of A-123, Appendix A, to be in a position to provide assurance concerning the effectiveness of internal controls over financial reporting for the USF.

USAC continues to work toward full implementation of the requirements outlined in A-123, including Appendix A. We expect to have initiated appropriate remediation activities as based on our analysis of GT's *Assessment of Internal Controls over Financial Management Processes*, retested to ensure the efficacy of the remediation activities, and be ready to provide assurances on our internal controls over financial reporting of the USF in preparation for an attest examination as of December 31, 2009.

A robust system of internal controls can only strengthen USAC's administration of the USF, and USAC is committed to implementing and continually improving our program.

As stated at the beginning of this letter, this is essentially a procurement issue that should have been resolved quickly. As discussed above, PwC cannot conduct an attest engagement regarding USAC's system of internal control as of December 31, 2008 as directed by your December 15, 2008 letter. USAC is still required by 47 C.F.R. § 54.717, however, to complete an annual financial audit and AUP review within 105 calendar days after USAC fiscal year-end. Although the USAC Board of Directors approved the engagement of PwC to perform this work many months ago, as of the date of this letter, USAC has been unable to begin either of these engagements with PwC because Commission staff has blocked USAC's request to renew the agreement with PwC. USAC reiterates its request from October 1, 2008 for immediate FCC staff approval to exercise the first option year of the competitively-bid contract with PwC for USAC's annual financial audit and AUP review required by Commission regulations. More than three months have passed since USAC's original request, and we are less than 100 days from the deadline set forth in 47 C.F.R. § 54.717(f). USAC is extremely concerned regarding this matter, as USAC's ability to meet the regulatory deadline is a matter of great importance to its Board of Directors and management. USAC will do all it can to work with PwC to meet the deadline, but USAC believes it is highly unlikely that the deadline for submission of both the financial audit and AUP reports can be met even if PwC was authorized to begin its work immediately.

USAC looks forward to obtaining your approval to engage PwC to conduct the financial audit and AUP review and finally beginning work on the important audit activities required by Commission regulations.

Sincerely,

/s/

Richard Belden
Chief Operating Officer

cc: Dana Shaffer, Chief, Wireline Competition Bureau (via email only)
Kent Nilsson, Inspector General (via email only)

Enclosures: Letter from Richard A. Belden, Chief Operating Officer, USAC, to Anthony J. Dale, Managing Director, FCC, dated October 1, 2008

Letter from Anthony J. Dale, Managing Director, FCC, to Scott D. Barash, Acting Chief Executive Officer, USAC, dated November 13, 2008

Letter from Richard A. Belden, Chief Operating Officer, USAC, to Anthony J. Dale, Managing Director, FCC, dated November 21, 2008

Letter from Richard A. Belden, Chief Operating Officer, USAC, to Anthony J. Dale, Managing Director, FCC, dated December 9, 2008

Mr. Anthony Dale
January 13, 2009
Page 9 of 9

Letter from Anthony J. Dale, Managing Director, FCC, to Scott D. Barash, Acting
Chief Executive Officer, USAC, dated December 15, 2008

Letter from Donald W. Phillips, Partner, PwC, to Richard A. Belden, Chief Operating
Officer, USAC

ATTACHMENT H

Letter from PricewaterhouseCoopers LLP to
Richard A. Belden, Chief Operating Officer, USAC, dated January 13, 2009

January 13, 2009

Mr. Richard Belden
Chief Operating Officer
Universal Service Administration Company
2000 L Street, N.W.
Suite 200
Washington, DC 20036

Dear Mr. Belden:

We understand that during 2008, the Universal Service Administrative Company ("USAC") engaged Grant Thornton, LLP, to assist in establishing a formal internal control program consistent with Office of Management and Budget ("OMB") Circular No. A-123. You have informed us that USAC is in the process of completing the testing phase of its internal control program and that USAC expects to receive the final report on the results of this testing from Grant Thornton on or around January 31, 2009. Remediation and any necessary retesting will occur after receipt of the report.

Based on the current status of this two-year project, you have informed PricewaterhouseCoopers, LLP ("PwC") that management of USAC is not in a position at this time to provide PwC with the required assertions and representations related to an attestation engagement regarding the effectiveness of USAC's internal control over financial reporting as of December 31, 2008. In this regard, you have asked us to determine the impact of the inability of management to provide such assertions and representations at this time on PwC's ability to conduct and complete an attestation engagement for the year ended December 31, 2008.

We have reviewed and interpreted the applicable professional standards issued by the American Institute of Certified Public Accountants ("AICPA") and the Government Auditing Standards issued by the Government Accountability Office ("GAO"). In our judgment, AICPA Attestation Standard No. 501 ("AT 501"), published in September 2008, entitled *An Examination of an Entity's Internal Control Over Financial Reporting That is Integrated with an Audit of its Financial Statements*, is the applicable professional standard. The GAO has incorporated the AICPA's standards for attestation engagements into Generally Accepted Government Auditing Standards ("GAGAS").

Paragraphs .12 and .13 of AT 501 state:

.12 An auditor may perform an examination of internal control only if the following conditions are met:

- a. Management accepts responsibility for the effectiveness of the entity's internal control.
- b. Management evaluates the effectiveness of the entity's internal control using suitable and available criteria.
- c. Management supports its assertion about the effectiveness of the entity's internal control with sufficient appropriate evidence.
- d. Management provides its assertion about the effectiveness of the entity's internal control in a report that accompanies the auditor's report.

.13 Management's refusal to furnish a written assertion should cause the auditor to withdraw from the engagement. However, if law or regulation does not allow the auditor to withdraw from the engagement and management refuses to furnish a written assertion, the auditor should disclaim an opinion on internal control.

Paragraph .12 sets forth four conditions that USAC management must meet in order for PwC to perform an examination of internal control. Paragraph .13 states that the auditor needs to withdraw from the engagement if a written assertion addressing the conditions in paragraph .12 cannot be provided by management. We are not aware of any applicable law or regulation that does not allow the auditor to withdraw from this engagement.

As noted above, you have informed us that USAC management cannot at this time provide PwC with such assertions related to the effectiveness of internal control over financial reporting as of December 31, 2008. You have informed us that this is due to the fact that the Grant Thornton project to review and test USAC's internal controls was not scheduled to be completed before December 31, 2008 and in fact has not been completed. Based on this information, PwC cannot conduct, or even enter into, an examination engagement on the effectiveness of USAC's internal control over financial reporting as of December 31, 2008.

If and when USAC confirms management will be able to meet the four conditions set forth in paragraph .12 of AT 501, including providing PwC with the



aforementioned written assertion on a timely basis, PwC would then be able to commence an internal control examination engagement.

However, PwC is currently prepared to conduct an audit of USAC's 2008 financial statements and perform the annual agreed-upon procedures engagement as required by Part 54 of the FCC's regulations governing USAC, and as set forth in our draft Engagement Agreements previously provided to you. Due to the significant delay in engaging PwC to perform these services, PwC has significant concerns regarding whether USAC can meet the FCC's established reporting deadline.

Please contact Donald W. Phillips, engagement partner, if you have any questions regarding the above.


PricewaterhouseCoopers LLP

ATTACHMENT I

Letter from Anthony J .Dale, Managing Director, FCC, to Scott D. Barash, Acting Chief
Executive Officer, USAC, dated February 13, 2009

FEDERAL COMMUNICATIONS COMMISSION
Washington DC 20554

**OFFICE OF
MANAGING DIRECTOR**

February 13, 2009

Mr. Scott D. Barash
Acting Chief Executive Officer
Universal Service Administrative Company
2000 L St. NW, Suite 200
Washington, DC 20036

RE: Request to Exercise One-year Priced Option for USAC's 2008 Annual Part 54 Audit

Dear Mr. Barash:

We have reviewed USAC's letter of January 13, reporting that an attest engagement for internal controls cannot be performed at this time.¹ To prevent further delays in USAC's annual Part 54 audit, we authorize USAC to exercise the year two renewal options in its existing contract with PricewaterhouseCoopers (PwC) for financial statement audit and for agreed-upon procedures.

In a letter dated March 14, 2005, the Commission provided USAC with procurement guidance that requires USAC to secure the approval of the Commission before issuing solicitations or making contract award decisions for: "(1) all sole source contracting actions above \$25,000; and (2) all competitive contracting actions in excess of \$250,000."² In addition, the Commission instructed that "USAC's contracting actions must be consistent with Federal Acquisition Regulation ("FAR") requirements to the extent applicable, including FAR requirements for full and open competition, permissible business practices, and audit requirements."³ These procurement requirements are also in the USAC/FCC Memorandum of Understanding, executed September 9, 2008.⁴

We authorize USAC to exercise the year two renewal options in its existing contract with PwC, for financial statement audit and for agreed-upon procedures. Pricing for the financial statement audit and agreed-upon procedures should be as provided in the

¹ Letter from Richard A. Belden, Chief Operating Officer, USAC to Anthony J. Dale, Managing Director, FCC, dated Jan. 13, 2009.

² Letter from Jeffrey Carlisle and Andrew Fishel, FCC to Lisa Zaina, USAC at 3 (Mar. 14, 2005) ("March 14, 2005 Letter").

³ March 14, 2005 Letter at 2.

⁴ See Memorandum of Understanding between the Federal Communications Commission and the Universal Service Administrative Company, executed September 9, 2008, at 6-7.

existing contract. Within seven days after you enter into any contract amendment, engagement letter, or other contractual action with PwC, please send us a copy of such document.

This letter does not constitute approval of any contract actions except exercise of the year two renewal options for financial statement audit and for agreed-upon procedures. In particular, this letter does not authorize USAC to purchase any advisory or consulting services.

If you have any questions, please do not hesitate to contact me. Thank you for your prompt attention to this matter.

Sincerely,


Anthony J. Dale
Managing Director

For Anthony Dale

cc: USAC Board of Directors
Mark Stone, Deputy Managing Director, FCC
Mindy Ginsburg, Deputy Managing Director, FCC
Mark Stephens, Chief Financial Officer, FCC
Kent R. Nilsson, Inspector General, FCC
Dana Shaffer, Chief, Wireline Competition Bureau, FCC
David Reed, Financial Operations, FCC